FILE COPY

SUPREME COURT, U.S.
FILED
OCT 13 1939
CHARLES ELMORE CROPLEY
CLERK

No. [redacted]

In the Supreme Court of the United States

October Term, 1939

[redacted]

Petitioner,

v.

[redacted]

Respondent.

On Petition for Certiorari to the [redacted]

Petition

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	3
Argument	4
Conclusion	8
Appendix	9

CITATIONS

Cases:	
Davis v. *United States*, 87 F. (2d) 323, certiorari denied, 301 U. S. 704	7
Helvering v. *Winmill*, 305 U. S. 79	7
Johnston v. *Commissioner*, 86 F. (2d) 732, certiorari denied, 301 U. S. 683	4, 5, 6, 7
Jordan v. *Roche*, 228 U. S. 436	6
Klingenstein v. *United States*, 18 F. Supp. 1015, certiorari denied, 302 U. S. 716	7, 8
United States v. *Coulby*, 258 Fed. 27, affirming 251 Fed. 982	5
Statutes:	
Revenue Act of 1932, c. 209, 47 Stat. 169:	
Sec. 23	9
Sec. 181	11
Sec. 182	11
Sec. 183	11
Sec. 184	11
Sec. 185	12
Sec. 186	12
Sec. 187	12
Sec. 188	12
Sec. 189	13
Revenue Act of 1938, c. 289, 52 Stat. 447, Section 182 (U. S. C. Supp. IV, Title 26, Sec. 182)	5, 7, 13
Miscellaneous:	
Treasury Regulations 77, promulgated under the Revenue Act of 1932:	
Art. 121	13
Art. 282	14

197329—39

BLANK PAGE

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 548

HARRY H. NEUBERGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 20–23) is reported in 37 B. T. A. 223. The opinion of the Circuit Court of Appeals (R. 46–50) is reported in 104 F. (2d) 649.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 29, 1939 (R. 53). The time within which to apply for a writ of certiorari was extended for a period of 60 days from that date by an order signed on

September 26, 1939 (R. 54). The petition for a writ of certiorari was filed on November 21, 1939. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

During the year 1932 the taxpayer was engaged in the business of trading in securities on the floor of the New York Stock Exchange for a partnership of which he was a member and also for his individual account. The commissions upon purchases which the taxpayer made for his own account were paid by him to the partnership and were reflected in the partnership income of which the taxpayer received his distributive share. The questions presented are:

1. Whether, under Section 23 (r) of the Revenue Act of 1932, a loss sustained by the taxpayer on his individual transactions in stocks and bonds which were non-capital assets may be offset against his share of partnership profits realized during the same period from sales or exchanges of similar non-capital assets.

2. Whether Section 23 (r), if construed to prevent such offsetting, is unconstitutional.

3. Whether the commissions paid by the taxpayer upon purchases of securities for his own account are deductible as a business expense.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved are printed in the Appendix, *infra,* pp. 9–14.

STATEMENT

The facts as stipulated (R. 12–19) and as found by the Board of Tax Appeals (R. 20–22) may be summarized as follows:

Petitioner, a resident of New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on the floor of the Exchange for the partnership of Hilson & Neuberger, of which he was a member, on behalf of customers of the partnership, and for his individual account (R. 20–21).

During the year 1932, petitioner sustained a net loss of $25,588.93 from his individual trading in securities which were not capital assets as defined in Section 101 of the Revenue Act of 1932. In computing this loss he treated commissions which he paid upon the purchase of securities as part of their cost. The commissions were paid by the taxpayer to the firm of Hilson & Neuberger and were reported by it as income for 1932; they were not separately deducted in the taxpayer's return for that year (R. 21).

Hilson & Neuberger, as a partnership, derived a profit of $142,802.29 during the taxable year from sales of securities which were not capital assets within the meaning of Section 101 of the Revenue Act of 1932. The firm had other income, including commissions received, of $170,830.65 and deductions of $203,981.78, or a net income of $109,651.06 (R. 21). The taxpayer's distributive share of the partnership profits amounted to $44,158.55 (R. 15).

In his income tax return for 1932, petitioner deducted from his net taxable income the loss of $25,588.93 which he had sustained in his individual transactions in non-capital assets. The Commissioner disallowed the deduction and the taxpayer thereupon sought review in the Board of Tax Appeals. Before the Board, the taxpayer claimed that he was entitled to the deduction disallowed; he also claimed, in the alternative, that should the Commissioner's action be sustained, he was entitled to deduct as a business expense the commissions which he had paid on the purchase of securities sold in 1932. The Board held that the taxpayer was not entitled to deduct the loss of $25,588.93 sustained in his transactions in non-capital assets, but that he was entitled to deduct the commissions of $2,133.63 paid on the purchase of securities sold during the taxable year. Both parties appealed to the court below, which held that neither deduction was allowable.

ARGUMENT

1. Petitioner's claim that he is entitled to deduct the loss of $25,588.93 sustained in the purchase and sale of non-capital assets is based on the theory that under Section 23 (r) of the Revenue Act of 1932 non-capital losses sustained by a taxpayer as an individual may be offset against his distributive share of partnership income to the extent that such income is derived by the partnership from non-capital gains. The court below decided this issue against petitioner on the authority of its own earlier decision in *Johnston* v. *Commissioner*, 86 F. (2d) 732, where the holding was that under Section 23 (r), partnership income derived from a non-capital gain

does not retain its peculiar character as a non-capital gain when it is distributed to the members of the partnership and that, therefore, an individual non-capital loss of one of the partners may not be offset against his distributive share of the partnership profits. This Court denied certiorari in the *Johnston* case, 301 U. S. 683.

This aspect of the decision below, which involves merely a narrow question of statutory construction, is not in conflict with any decision of this Court or of any other circuit court of appeals.[1] It presents no question of general importance because Congress, by Section 182 of the Revenue Act of 1938 (c. 289, 52 Stat. 447), has expressly provided that for the year 1938 and subsequent years taxpayers may deduct personal losses on the sale of non-capital assets from partnership gains derived from the sale of similar assets. In view of the enactment of this statute there is even less occasion to review the decision in this case than there was to review the decision in the *Johnston* case, *supra*.

---

[1] There is no conflict, as petitioner asserts, with *United States* v. *Coulby*, 258 Fed. 27 (C. C. A. 6th), affirming, *per curiam*, 251 Fed. 982 (N. D. Ohio). The question there was simply whether, under the income tax law of 1913 (c. 16, 38 Stat. 172), a member of a partnership was required to include in his net income subject to the normal tax such part of his distributive share of the partnership profits as reflected income derived by the partnership from dividends on corporate stock. The decision that the taxpayer was exempt from taxation on this portion of the partnership income was based squarely on the court's interpretation of the specific provisions of the 1913 Act. The decision, therefore, is in no way inconsistent with the decision below, which is based upon the construction of entirely different provisions of an entirely different revenue law.

2. In the court below, petitioner contended that Section 182 of the Revenue Act of 1938, specifically allowing, for the year 1938 and subsequent years, the type of deduction disallowed to the taxpayer for the year 1932, showed Congressional disapproval of the ruling in the *Johnston* case and required the conclusion that Congress intended that the deduction claimed should be allowed under the Revenue Act of 1932. The refusal of the court below to adopt this contention is alleged to be in conflict with the decision of this Court in *Jordan* v. *Roche*, 228 U. S. 436.

In the *Jordan* case, the question was whether Porto Rican bay rum was taxable under the general provisions of an act of 1900. In an earlier case, the Circuit Court of Appeals for the Second Circuit had held the product to be exempt under the 1900 act. Thereupon Congress, in 1909, enacted a statute specifically providing for the taxation of Porto Rican bay rum. The taxpayer in the *Jordan* case urged that this specific provision embodied in the later statute indicated that the product was not taxable under the 1900 act. This Court rejected the contention, stating that the history of the later statute showed that it "was not the declaration of a new policy but a more explicit expression of the purpose of the prior law, made necessary by the judicial construction of that law." (228 U. S. at 446.)

There is nothing inconsistent between the decision in the *Jordan* case and the decision below. The usual inference is that when a statute is amended the purpose is that of change rather than that of declaring its former meaning. In the *Jordan* case this inference was refuted by legislative history clearly indicating that the partic-

ular amendment involved was intended merely as an explicit expression of the purpose of the prior law. There is no comparable legislative history here and petitioner points to no reason why, under the circumstances of the present case, the usual inference should not be drawn.

3. Disallowance of the deduction for the taxpayer's loss on the sale of non-capital assets does not, as petitioner suggests, present an important or doubtful question of constitutional law. The right to take deductions is wholly a matter of statutory privilege which may be granted or withheld in the discretion of Congress. The constitutional issue which petitioner seeks to raise has been decided against him in other cases in which this Court has denied petitions for writs of certiorari. *Johnston* v. *Commissioner, supra; Davis* v. *United States,* 87 F. (2d) 323 (C. C. A. 2d), certiorari denied, 301 U. S. 704; *Klingenstein* v. *United States,* 18 F. Supp. 1015 (C. Cls.), certiorari denied, 302 U. S. 716. Moreover, because of the enactment of Section 182 of the Revenue Act of 1938, the question will not arise for any year subsequent to 1937.

4. The only other reason advanced for issuance of the writ relates to the holding of the court below that the taxpayer was not entitled to a deduction as a business expense of the commissions of $2,133.63 which he paid to the firm of Hilson & Neuberger on the purchase of securities sold by him during 1933. Petitioner alleges that this holding "erroneously interprets" the decision of this Court in *Helvering* v. *Winmill,* 305 U. S. 79; no conflict with that decision or with the decision of any other circuit court of appeals is shown.

In *Helvering* v. *Winmill*, this Court held that commissions paid upon the purchase of securities are not deductible from income but must be added to the cost of the securities. Petitioner urged in the court below that the rule there declared is not applicable to this case because the commissions here were paid by petitioner to his partnership and were reflected in the partnership income, of which petitioner received his distributive share. The attempted distinction has no support in principle or authority. The court below was clearly correct in holding that the interest of the taxpayer in the brokerage firm to which he paid the commissions did not change the character of the commissions as capital expenditures of the taxpayer.

CONCLUSION

The decision of the Circuit Court of Appeals is correct, and is not in conflict with any decision of this Court or of any other circuit court of appeals. The petition for a writ of certiorari should be denied.

Respectfully submitted.

ROBERT H. JACKSON,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
F. E. YOUNGMAN,
Special Assistants to the Attorney General.
RICHARD H. DEMUTH,
Special Attorney.

DECEMBER 1939.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(e) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(r) *Limitation on Stock Losses.*—

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1), computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets.

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory, nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business.

(s) *Same—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

(t) *Definition of Stocks and Bonds.*—As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, or (2) rights to subscribe for or to receive such shares, or (3) bonds, debentures, notes, or

certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision thereof), with interest coupons or in registered form, or (4) certificates of profit, or of interest in property or accumulations, in any investment trust or similar organization holding or dealing in any of the instruments mentioned or described in this subsection, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of this Act.

SUPPLEMENT F—PARTNERSHIPS

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

(a) *General Rule.*—There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. If the taxable year of a partner is different from that of the partnership, the amount so included shall be based upon the income of the partnership for any taxable year of the partnership ending within his taxable year.

* * * * *

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called "charitable contribution" deduction provided in section 23 (n) shall not be allowed.

SEC. 184. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such

amounts of dividends and interest specified in section 25 (a) and (b) as are received by the partnership.

SEC. 185. EARNED INCOME.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

SEC. 186. CAPITAL NET GAINS AND LOSSES.

In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under the rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

SEC. 187. NET LOSSES.

The benefit of the special deduction for net losses allowed by section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 188. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 189. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 121. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141–272. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business,

traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. As to items not deductible, see section 24 and articles 281–284.

ART. 282. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (k) and article 201.) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1939